Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	John Campbell	Analyst:	LuAnna Hass	Bill Number:	ACA 22
Related Bills:	See Legislative History	Telephone:	845-7478	Introduced Date:	May 20, 2002
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Appropriations Limit/FTB And Controller Facilitate Timely Issuance Of Tax Rebates

SUMMARY

This measure would require the Franchise Tax Board (FTB) and the State Controller to issue rebates of a portion of the revenues received by the state in excess of the amount appropriated by the State during the fiscal year.

This analysis will not address the measure's changes to the other provisions of the California Constitution regarding various appropriations and the State School Fund as they do not impact the department or state income tax revenue.

PURPOSE OF THE BILL

According to the author's staff the intent of this measure is to revise the process to return excess revenue to taxpayers via the income tax system.

EFFECTIVE/OPERATIVE DATE

This measure would become effective and operative the day following approval by the voters in the next general election, which would be November 5, 2002, if such approval occurs.

POSITION

Pending.

ANALYSIS

STATE LAW

Under the California Constitution, the voters of the State have the authority to approve or reject any amendments to the State Constitution. Private citizens or groups can initiate amendments or the Legislature may place an amendment on the ballot if the proposal passes each House by a two-thirds vote. The Legislature proposes amendments to the California Constitution by passing a Senate Constitutional Amendment (SCA) or an Assembly Constitutional Amendment (ACA). Neither an SCA nor an ACA require the approval of the Governor. After the Legislature approves an SCA or ACA by two-thirds vote, it is assigned a proposition number and placed on a statewide ballot for the voters to approve or reject the proposed change. Any amendment to the Constitution proposed by the Legislature and adopted by a majority vote of the people takes effect the day after its adoption.

Board Position:			Department Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Alan Hunter for GHG	6/28/02
____ N	____ OUA	X PENDING		

Existing provisions of the California Constitution prohibits a government entity's annual appropriation from exceeding its annual limit, which is adjusted annually for the cost of living and population changes. Currently, 50% of the excess revenues that are received by the State in a fiscal year, which is in excess of the amount that may be appropriated by the State for that same fiscal year, are transferred to the State School Fund. The remaining 50% of the excess revenues must be returned by the State by revising tax rates or fee schedules within the next two subsequent fiscal years.

THIS BILL

This measure would require that a portion, not to exceed 5%, of the excess funds received by the State in a fiscal year in excess of the amount appropriated by the State must be transferred to a State Budget Revenue Shortfall Account. Of the remaining excess funds, this bill would require that 50% be transferred to the State School Fund. The remaining excess funds must be held in a rebate account. At the end of each fiscal year, the funds in the rebate account would be rebated to certain California taxpayers on a pro rata basis. The rebates would be issued to persons, corporations, or other entities that paid taxes on, or measured by, income for taxable years that began during the most recent taxable year. FTB and the Controller would be authorized to jointly take any necessary actions that would facilitate the issuance of timely rebates. This measure would be self-executing, meaning the rebate process would begin once the State has realized the appropriate excess revenues. Enabling legislation would not be required, but legislation may be enacted to facilitate the operation of the rebate process, so long as the legislation does not conflict with this measure.

IMPLEMENTATION CONSIDERATIONS

The Revenue and Taxation Code requires FTB to administer and enforce the income tax laws. This constitutional amendment generally would require FTB and the Controller to oversee the issuance of rebates. Additional enabling legislation would not be needed for the issuance of rebates if the voters pass the proposed constitutional amendment and the State receives excess funds subject to rebate under this measure.

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the measure moves through the legislative process. In order for FTB to implement this measure, clarification is needed for at least the following issues:

- Clarification of the phrase "pro rata basis." Under this measure, funds must be rebated to California taxpayers on a pro rata basis to persons, corporations, or other entities that paid taxes on, or measured by income. It is unclear what specific criteria or measures FTB would use to determine the pro rata share of rebate for each taxpayer. The following are a few of the questions that should be addressed:
  - Would the rebate amount be based on factors such as total income or total tax?
  - Would there be a minimum or maximum rebate amount?
  - Would the rebate amount for taxpayers who are married and filing a joint tax return be twice the amount of a rebate for an individual taxpayer?

  In addition, the department receives annually approximately 2000 Corporation Franchise Tax returns from corporations that have income of at least $10 million, which accounts for 70% of the franchise tax payments. If "pro rata basis" were based on tax paid and corporations were eligible for the rebate under this bill, then these corporations would receive a bulk of the rebate funds.

- Provisions of the Internal Revenue Code require reporting of state or local income tax refunds to the IRS. Although the rebate payments are based on funds available from excess state revenues, and not solely derived from excess income taxes paid, it is likely that the rebate would be required to be reported to the IRS.
- Could rebate payments be revised after issuance? Depending on the factors determining the pro rata rebate amount, certain circumstances could result in rebate revisions. These factors include the receipt of amended returns, audit adjustments, or processing errors.
- How will offsets to FTB, the Internal Revenue Service, and other State agencies be handled? Currently, these agencies participate in an agency-offset process where refunds are offset to satisfy an outstanding liability owed by the taxpayer to another government entity. Since this is a rebate of excess state revenues as opposed to a refund of taxes, clarification would be needed on whether these rebates would be subject to the agency-offset process.

If these concerns and any additional concerns that may be identified are not clarified in this measure, then the department would need future enabling legislation prior to the issuance of the rebates.

In addition, if FTB were responsible for issuing the rebates as proposed by this measure, the department would need to create a new system for issuing and processing the rebates. This measure does not include an appropriation to cover the costs of developing a system for issuing and processing the rebate. Without an appropriation the department would be required to redirect resources from revenue producing activities to implement this measure.

LEGISLATIVE HISTORY

SCA 16 (McClintock, et al., 2001/2002), which is similar to this bill, would require FTB and the State Controller to issue rebates of any revenues received by the state in excess of the amount appropriated by the State during the fiscal year. This bill is with the Senate Revenue and Taxation Committee.

A version of AB 2869 (Machado, Stats. 2000, Ch. 977) prior to enactment would have authorized a sales and use tax rebate to qualified taxpayers of $50 or a variable amount based on the taxpayer’s filing status and federal adjusted gross income. This provision was removed from the bill.

AB 2609 (Stats. 1987, Ch. 915) and SB 47 (Stats. 1987, Ch. 908) authorized a tax rebate of excess funds for the 1986 taxable year. Qualified taxpayers were allowed a tax rebate of 15% of the tax imposed by the income tax law, as defined, with specified minimum dollar limits and maximum dollar limits. The rebate was calculated and administered by FTB and required rebate checks to be sent by the Controller to taxpayers by January 15, 1988.

OTHER STATES’ INFORMATION

A review of the state laws and Constitutions of *Florida, Massachusetts, Michigan,* and *Minnesota,* found the following:

- *Florida* and *Minnesota* require excess revenues to be refunded to the taxpayers.
- *Massachusetts* allows a credit, called the “excess revenue credit,” toward taxpayers’ personal income tax liabilities.
- *Michigan* requires excess revenue to be refunded on a pro rata basis that is based on the liability reported on the Michigan income tax and single business tax returns.

A review of *New York* and *Illinois* state laws and Constitutions did not produce any information regarding procedures for excess revenues. The laws of these states were reviewed because of similarities to California income tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be significant. At a minimum, the department would need to implement a system to calculate and issue the rebates proposed in this bill.

ECONOMIC IMPACT

This measure would not impact personal income tax and corporate tax revenues.

ARGUMENTS/POLICY CONCERNS

The rebate of excess State revenue could be accomplished more efficiently through a change in 1) tax rates, 2) taxable income brackets, or 3) the standard deduction. A special tax credit that could be claimed on the ensuing year's tax return also could be effective. However, a change in the tax rates, income brackets, or standard deduction would benefit fewer Californians because only those with taxable income would realize the savings. On the other hand, a special refundable tax credit may cause the State to pay out more in refunds than is available in excess revenue because an increase in fraud is generally associated with refundable credits.

LEGISLATIVE STAFF CONTACT

LuAnna Hass	Brian Putler
Franchise Tax Board	Franchise Tax Board
845-7478	845-6333
LuAnna.Hass@ftb.ca.gov	Brian.Putler@ftb.ca.gov